Case Study No 10

Co-operative Purchasing - Farming

United Farmers Co-operative Company Limited Story

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Recommended corrections and additions welcome.

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Co-operative Federation of Victoria Ltd

The united farmers co-operative company limited story

The principles:

1 *There must be a need for a cooperative*

2 *The economic environment must be right*

3 *Passionate people driving the movement*

4 *A clear plan and a clear direction*

5 *Set achievable targets and goals and match your strategy with the structure*

6 *Establish kpi's to monitor the performance and trend lines of the cooperative*

7 *Continually communicate with members;*
– What do they want (not what the directors and management want)
– Communicate the cooperative story
– Where do they want the cooperative to go
– What are the dangers and opportunities

8 *Director and member education is essential*

9 *Capital raising issues must be addressed and sufficient funds kept within the organisation for growth and tough years*

During the eighties, seasons had been good and commodity prices, particularly wool had been bullish. Rural communities were booming. However by the late eighties and early nineties, the rural environment had changed. The price of wool and sheep had collapsed with the removal of the "immutable" "floor price scheme" for wool devised by the late Sir William Gunn. The price of wheat had collapsed to less than the cost of production and interest rates had risen to record highs.

The Federal Government had removed the "Guaranteed Minimum Price" scheme for wheat and had notified growers that the Australian Wheat Board was to be privatised and lose Government underwriting. Farmers who had been cashed up after the boom period of the eighties and had taken the plunge to invest in more property, were reeling under the burden of debt and rural communities were in steep decline.

With the conversion of Westralian Farmers Cooperative to a company in the mid eighties, competition on farm inputs such as fertiliser and chemicals was almost non-existent and prices on these inputs in particular had risen dramatically. The price of single superphosphate had risen from $22 per tonne in the late 70's to $120 by the late eighties.

Glyphosate (Roundup) was selling for $325 per 20 ltr drum or $16 per ltr and Duponts "Glean" and "Ally" were selling for about $1 per gram. Wesfarmers annual report for 1991 stated that $50m of their groups $55m profit had been derived from fertiliser sales.

Not since the great depression of the 30's had there been a need for a cooperative to be formed.

The United Farmers Cooperative was registered on the 8th July 1992. It consisted of 5 farmer members each contributing $1000 in share capital. A strategic plan had been drafted in the Morawa Shire Council chambers in late July. The new directors had agreed that our main objectives would be to lower the price of farm inputs to our members and wherever possible, increase the return for farm-gate produce prices. We identified the four major cost centres for farmers as being fertiliser, chemicals, finance and fuel. Initially, we would concentrate on fertiliser and then when established, would move on to chemicals, then finance and fuel. A "statement in lieu of prospectus" was issued and the task of informing the rural communities had begun.

Passionate people must be prepared to work hard for no personal gain

The task of spreading the word had fallen on me and I arranged meetings from Esperance to Northampton and all places in between. By October, we had raised about $66,000 in share capital, had employed a manager and had set about the task.

Because of our low capital base, we could not afford to employ all the people required to run an import business. We decided to contract out our procurement and shipping to external sources and pay them on a commission basis. We would therefore know in advance what our fixed costs would be and by minimising our overheads, would be able to provide an extremely low cost quality product to our members. The vast majority of our fertiliser was discharge directly into farmer's trucks at the wharf and we hired additional storage as required.

Conbata Pty Ltd was contracted to be our procurement agent on a commission of $1USD per tonne and BakkeShipping Pty Ltd was commissioned to arrange our shipping and logistics requirements. That left the cooperative free to concentrate on making contact with members and potential members throughout the state. Because of our low capital base, and inexperience, the banks would not issue us with credit.

We required the members to pay well in advance for their fertiliser. Once the capital for the fertiliser had been raised and a letter of credit had been drafted, Conbata and Bakke did the rest.

Our turnover in the first year was $14.7m resulting in a profit of over $1m.

Start-up capital raising in the first year had been extremely difficult and it was decided to rebate the surplus back to our members in the form of bonus shares and cash in the proportion of 80% - 20%. No dividend was to be paid. We believed that the dividend to our grower members was in the form of lower cost fertiliser. This allowed us to build our share capital to $1m in just one year.

The strategy the following year was similar to the first, however, our competition had recognised our weaknesses and managed to keep our profit to $400,000. The distribution of profits in the second year was made in the same manner as the first.

In the third year, our competition had honed in on the most significant weakness – the fact that we had very little working capital and no means whereby we could offer an early up-front price. CSBP had significantly reduced the number of its workforce. 600 people within the group had been retrenched since we commenced business and they had decided to either get rid of us or make it extremely difficult for us to trade. Early in the third season of trading, international prices of fertiliser, particularly urea had increased significantly. CSBP were offering urea to the market at $270 per tonne, and indications from our projected cash flow budget indicated a break-even cost for urea in excess of $400.

To take the risk of bringing in a shipment of urea that year meant that we stood to risk our entire share capital to a loss. We then made the decision that it was in our member's best interest for us not to trade and notified them by fax, phone and letter, that the prices being offered by the competition were lower than what we could purchase the product for. We suggested that they immediately lock in their contracts with the opposition as these low prices could not last. Within two weeks of the letter being sent to shareholders, the price of urea in the Western Australian market had risen by $180 per tonne. Although we realised that we would not make a profit that year, we had achieved our goal of significantly lowering the price of fertiliser to our members by supplying them with information on which they could make their own decision. We had also added chemicals to our range of inputs, significantly reducing the price of Glyphosate, Ally and Glean prices. The principles of cooperation were working well.

Realistic and effective strategic planning is essential

The events of the 1995 year made it obvious to us that strategic planning was essential to the success or failure of any organisation, and we decided to arrange a strategic planning exercise with the Australian Institute of Management. We ran a comprehensive SWOT analysis and planned 3 years into the future. We studied the external environment in much more detail than we had previously and with the assistance of our new manager, Ian Barnden-Brown went forward with a clear direction and strategy. In 1997 we doubled our turnover, made a $2.7m profit and achieved a 100% return on share capital. With the additional capital behind us, and improved relations with the bank, our trading terms were more flexible and acceptable in the market.

In 1998, our turnover again doubled and once again we returned 100% return on share capital. We now had sufficient funds and credibility with our financiers to commence a storage facility building program. The AQIS rules had been changed, and it was now extremely difficult to discharge directly into farmer's trucks on the wharf. With the large amount of capital expenditure required to build storage facilities, came a whole different set of dynamics for the cooperative. No longer were we a lean, mean, manoeuvrable operation. We now had overheads with significant associated costs, regardless whether we brought in fertiliser or not. We were now entering a different phase of our history. It was essential that we achieve an acceptable turn over every year whilst at the same time keeping the cost of product at an acceptable level to our members. We drew criticism from many of our members for building sheds at all major ports, however to achieve long term sustainability, it was imperative that we do so.

Strategic planning is essential not only for the financial success of the cooperative, it is also important for harmonious board / management relations. The strategic plan must be completed prior to the budget being formulated and the budget should then be based on the plan. Failure to achieve acceptance of the strategic direction of the cooperative by all board members will result in disharmony at board level, which will then flow on to management. Rushing through the plan is not an option and while there may be hot debate on issues, it is important to reach consensus on all issues. It is essential that member's needs are catered for in the strategic plan and not to satisfy the wishes of board members or of management.

Capital raising is essential

The United Farmers Cooperative has been fortunate in this respect. Large profits were possible in our formative years because of the lack of price sensitive competition. Our conversion of profit into share capital was one of the key reasons for our rapid growth. We had provided our members with a cheaper supply source and they were quite happy for us to convert the surplus into share capital. We have a ceiling on share ownership to a maximum of $22,000 per member. After this ceiling is reached, all surplus profits generated from individual members trading is rebated back to them in the form of cash. We have never paid a dividend apart from the dividend on a very small issue of preference shares. Almost all of the UFCC share capital has been raised through profit distribution.

I believe that cooperatives who distribute too much of their surplus back to the members in the form of cash or better prices run the risk of collapse in a tough or “loss” year. Shepherds Producers Cooperative is a good example of this type of operation.

Monitor performance with key performance indicators (kpi’s) to develop trends and potential weaknesses

Good Key Performance Indicators give a snapshot of the cooperatives performance to even the least experienced director. A simple KPI such as the “Cost of Sales” in a percentage format will give the director an indication of how the cooperative is performing against budget and against the trend of previous years. Another good KPI is the percentage of participating members. If the trend is for less members participating, the cooperative is not satisfying their needs. Management tend to want to place those KPI’s which reflect good performance, before the board. Make sure that the KPI’s you choose are the right ones to identify the key aspects of the financial, trading performance and member participation.

UFCC policy requires management to achieve no less than 90% trading with members.

Communication with members

This is another critical element of good cooperation. Information flow both to and from the members is essential to communicate their needs and also the opportunities and current events at management and director level.

The United farmers Cooperative sends out a questionnaire to members every year, with every second year being a comprehensive document. The questionnaire is drafted and analysed by an independent source to ensure the questions asked are not biased in any form. Ideally, these questionnaires should be received and analysed well prior to the commencement of the strategic planning exercise. Failure to identify with the members requirements could result in the failure of the cooperative. If the cooperative is not providing the member with what they require, corporate competition is always keen to accommodate cooperative members needs, and there is no requirement for the farmer to invest funds into the corporation in order to trade.

Policy governance

The United Farmers Cooperative board believe in policy governance.

A comprehensive document of policies has been formulated and drafted over the 11 year period we have been operating. This document is reviewed each year to ensure it is current with the strategic direction of the cooperative and caters for all major policy issues. The document then forms the boundaries within which management have the scope and authority to manage the cooperative. It reduces discussion of an operation nature at board meetings and gives management comfort in knowing what they can and can’t do.

Summary

Over the past 11 years the UFCC board has ensured that adherence to these 9 principles has resulted in growth, sustainability and member benefits.

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